Investing involves risk. The value of an investment and the income from it may fall as well as rise and investors may not get back the full amount invested.

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Investment Insights from Silicon Valley

www.allianztechnologytrust.com

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With over 40 years of experience of investing in technology companies, Walter Price has witnessed the evolution of the technology sector from the birth of the personal computer to the arrival of the internet and now the shift to cloud computing. Based in San Francisco, giving him close proximity to many of the world's most innovative companies, he heads up the Global Technology Team which manages US$4.5billion* in assets.

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*Source: Allianz Global Investors GmbH as at September 2015.

US election update

This edition of Investment Insights was prepared in advance of the results of the US presidential elections being announced. For our views on the results visit our website www.allianztechnologytrust.com.

Ericsson vs. Huawei

The shifting mobile market claimed another scalp last month as Ericsson reported a slump in profits. The Swedish telecoms equipment maker blamed rising competition and said it would continue to cut costs, but its problems are part of a wider phenomenon; notably, the difficulty of competing with China.

In this case, Ericsson's difficulties can be largely attributed to the strength of Huawei Technologies, which continues to take market share both domestically in China and across the globe. It is expanding across emerging markets, including Azerbaijan, Belarus and Kazakhstan, but it is also creating significant problems for lower cost providers in Europe and Asia.

Huawei's rise has not been without incident. It was sued by Cisco in 2012 for patent infringement, but this proved to be its making: it intensified its research efforts and now spends over 20% of its revenues on its research and development.

The result has been a significant improvement in the products it offers: this has seen it steal a march across the globe. It now has a core, loyal customer base, while Ericsson's only response has been to focus on cutting costs – hardly a long-term strategy for growth.

Börje Ekholm has now taken over as chief executive at Ericsson. He was chief executive of the Wallenberg family's main investment vehicle, Investor – the largest shareholder in Ericsson - for a decade until last year. However, it is difficult to see how he will find a means for Ericsson to compete in the unforgiving market of telecoms equipment.

R&D spending

Research and development spending certainly made a difference in Huawei's case, but does higher R&D spending necessarily make for a good technology company? It tends to reveal whether a company is really a technology company, but we look at R&D spend in a more nuanced way than simply as a percentage of revenues.

Amazon, for example, spends a lower percentage on technology development. Its R&D is primarily focused on the retail side and most of its development efforts go on logistics. Where it does spend on technology, however, it does it extremely efficiently. It was the first to use robots to improve the efficiency of its human packers. Robots could reach higher and understand the most efficient paths through the warehouse. By doing this, Amazon improved its productivity by 40%.

The changing picture for security

The security market is a little less frothy than it was a few years ago, when companies were willing to buy almost anything if they thought it would protect their systems. Now, most companies are taking a more thoughtful approach.

This is no recommendation or solicitation to buy or sell any particular security.
A ranking, a rating or an award provides no indicator of future performance and is not constant over time.

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Some companies have seen their business weaken as a result, even as overall spending on security has continued to grow. Those that have benefited have been those focused on protecting data in the cloud. More companies are moving their internal technology systems to the cloud, but it requires a more robust security environment because companies don't control it.

In particular, it has created a real need for data encryption: previously companies didn't encrypt data inside their data centres because they were generally protected by firewalls. Now, however, hackers could be in their environment. As a result, data encryption is considered very important, as is the ability to look in more depth at what is happening in the cloud. This has seen a shift in spending,

In our portfolio, we hold Proofpoint, a leading cybersecurity company, which secures email and social communications. Rather than using an on-premises server, emails are sent via Proofpoint, which looks at a company's emails, identifying any potential threats with sophisticated analysis. Anything questionable is put into a quarantine area and examined for malware. As it builds its business, so it builds a body of knowledge, cross-referencing malware from one group to another.

Twitter woes

Twitter has announced plans to cut 9% of its workforce, in a bid to make it more competitive. It caps a tough year for the social networking site, with Twitter stock down by more than 25% since January.

We haven't held Twitter shares in the portfolio for a while. It has been trying to reinvent itself and become more relevant, but has not been able to bridge the gap between those who are heavy users and understand the system, and those that come through Google or another site. This latter group are proving difficult to convert into regular users.

Equally, there is an increasing range of alternatives to Twitter. Facebook now has video capability, and the ability to search. There is YouTube on Google. If people are looking for breaking news in the form of text, Twitter might still have the edge, but even here it is losing ground. For breaking news, people may increasingly look to a newsfeed from Google on Facebook, while local TV stations might broadcast through a Facebook application.

Twitter's over-arching problem is whether it can be relevant? We don't believe its problems are fully reflected in the valuation. It is very difficult to catch up when ground is lost in social media.

An update on Apple

We may not be excited by the new iPhone, but the network carriers have seized the opportunity to grab customers with good upgrade deals, which is sustaining demand for new handsets. The upgrade cycle has proved better than expected with the added boost of problems at near-rival Samsung.

Apple shares are not expensive, currently traded at around 12x earnings. The shares have recently seen a rebound as earnings momentum reversed. We continue to have an underweight position in Apple shares, relative to the Trust's benchmark.

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